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**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554**

**FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY**

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In the Matter of

Federal-State Joint Board on
Universal Service

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CC Docket No. 96-45

**PETITION FOR RECONSIDERATION
of the
RURAL TELEPHONE COALITION**

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I. INTRODUCTION

The Rural Telephone Coalition (RTC) hereby submits this petition for reconsideration of the Commission's policy on the recovery of corporate operations expense through high loop cost support and its corresponding formula for capping such recovery established in the Universal Service Report and Order¹ and revised in the July 10, 1997 Order on Reconsideration.²

The RTC is comprised of the National Rural Telecom Association (NRTA), the National Telephone Cooperative Association (NTCA), and the Organization for the Promotion

¹ Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Report and Order, FCC 97-157, (rel. May 8, 1997) (Order).

² Federal-State Joint Board on Universal Service, CC Docket 96-45, Order on Reconsideration, FCC 97-246, (rel. July 10, 1997) (Order on Reconsideration).

and Advancement of Small Telecommunications Companies (OPASTCO). Together the three associations represent more than 850 small and rural telephone companies.

In the Order, the Commission established a formula, to be implemented on January 1, 1998, which would cap the amount of corporate operations expense that may be recovered through high loop cost support until such time as the new universal service mechanisms take effect. The formula, which limits expense recovery on a per-line basis, included two flaws which the Commission addressed in its Order on Reconsideration. First, the formula produced an anomaly in which the total recoverable amount of support would decline for companies with 6,780 - 12,913 access lines. Second, the formula did not consider that a certain amount of fixed expense exists for all companies irrespective of the number of access lines, and instead produced a bottomless downward slide of allowable expense recovery as the number of access lines declined. Despite the FCC's revisions,³ the formula, the flawed reasoning behind it, and its impact on rural telephone companies and their customers continue to raise serious concerns that warrant further reconsideration and modification.

II. REASONABLE AND PRUDENTLY INCURRED CORPORATE OPERATIONS EXPENSES ARE AN ESSENTIAL AND UNAVOIDABLE COST OF PROVIDING UNIVERSAL SERVICE

The Commission states that corporate operations expenses:

...do not appear to be costs inherent in providing telecommunications services but rather result from managerial priorities and discretionary spending. Consequently, we intend to limit universal service support for corporate operations expense to a reasonable per-line amount...⁴

³ The Commission modified the formula to allow total recoverable support amounts to increase proportionately with the number of working loops. It also established an expense recovery floor of \$9,505.90 per month. Order on Reconsideration, paras. 19-21.

⁴ Order, para. 283.

The RTC agrees with the Commission that support should only be provided for expenses incurred to provide universal service that are reasonable and prudent. However, the element of managerial discretion does not determine what costs are inherent in providing telecommunications service. Prudent managers exercise discretion in setting the level of all expenses including, for example, network plant and facilities, managerial salaries, and the cost of the professional services needed to operate the business. The loops and switches that transport telecommunications traffic are useless unless there is a company in place to manage and operate them. Companies incur operating costs. To the extent that such costs are prudent, they are every bit as important to providing service as the electronic hardware and software and should not be subject to an arbitrary cap.

A rural telephone company requires managing and planning and must operate in a complex legal and regulatory environment. The expense items included under USOA Accounts 6710 and 6720 that the FCC is calling discretionary include general managers, information management, accounting and financial services, legal services including guidance on regulatory matters, and government relations including the presentation of information for regulatory purposes. These expenses are the necessary costs of doing business as a regulated company and are hardly extraneous to the provision of service.

For example, compliance with FCC requirements such as cost separation studies, revenue requirement and settlement calculations, and special data requests impose costs that are not discretionary. Expenses such as external audits and tariff and service cost filings are not only mandatory, they have also been required to serve the public interest. And, as the

FCC charts new waters implementing the 1996 Act, rural LECs are all but forced to rely on cost consultants and legal counsel to interpret the meaning and impact of new regulations.

The Commission has no basis on which to invoke a formula that limits the recovery of such legitimate expenses, necessary in the provision of universal service. Nothing in Sec. 254 of the 1996 Act limits support to physical facilities. The Commission invokes Sec. 254(k)⁵ but that subsection requires it to do more than establish arbitrary guidelines before establishing cost allocation rules. In any event, the FCC already has cost allocation rules and Sec. 254(k) provides no authority for promulgating different rules without adequate notice and Administrative Procedures Act procedures.

Moreover, there is nothing to indicate that carriers serving high cost areas, taken as a whole, incur corporate operations expenses that are unreasonable or imprudent. These companies operate just as efficiently as any other segment of the telecommunications industry, particularly in light of their inherently limited economies of scale and greater volatility from changing conditions. If it is suspected that a company is incurring unwise or unreasonable expenses, then it would be appropriate for the Commission to conduct an investigation. If a positive finding is made, appropriate measures limiting the carrier's expense recovery should be taken. Otherwise, the Commission should maintain the presumption that carriers serving high-cost areas incur corporate expenses that are "within a range of reasonableness" and allow for the full recovery of such actual expenses while it develops its forward-looking mechanism for calculating their high-cost support.

⁵ Order, para. 283.

III. THE FCC SHOULD NOT IMPLEMENT AN UNTESTED FORMULA THAT MAY PROVE DETRIMENTAL TO RURAL CARRIERS AND THEIR CUSTOMERS

The Commission's formula is essentially a proxy for what is supposedly a reasonable level of corporate operations expense, using the number of access lines as the variable. As the RTC has stated in the past,⁶ a proxy must be proved valid in its prediction and assumptions before it can be prescribed. In the Universal Service Order, the FCC agreed and provided that for any proxy to be selected for use in the determination of forward-looking economic costs, data must be verifiable, assumptions reasonable and outputs plausible.⁷ In addition, the selected proxy must meet the nine other detailed criteria recommended by the Federal-State Joint Board.

Curiously, the FCC has not measured its own proxy for determining the appropriate level of corporate operations expense against the criteria recommended by the Joint Board and adopted by the Commission for evaluation of the forward-looking proxies. This would involve making the formula available to all interested parties for review and comment and ensuring the verification and plausibility of all underlying data, assumptions and outputs. Until such time as a formula has been shown to accurately predict that the corporate operations expenses for a particular company are unreasonable, the Commission should not impose an untested, proxy-based cap which will make it impossible to gauge whether the level of high cost support is "sufficient" as required by Sec. 254(b)(5).

⁶ See, for example, RTC Further Comments, CC Docket No. 96-45, August 9, 1996, pp. 7-11.

⁷ Order, para. 250.

Despite the FCC's addition of a support floor to its formula, it does not seem adequate to account for a small carrier's operating expenses that do not vary by the number of access lines. For example, management salaries do not vary greatly between the largest and smallest companies. Also, in some cases regulatory expenses for smaller carriers may be proportionately greater where rate of return companies face more regulation than price cap carriers. The point here is that just because one company faces higher costs for certain corporate expenses than another does not make those costs any less legitimate than the higher cost of the loops themselves. The reasonable corporate expenses of a small carrier cannot be easily determined through a simplistic access line-based model.

Even with the Commission's revisions to its original formula, it still does not appear that many small carriers will receive the necessary support to cover a reasonable level of expense. According to an analysis of the FCC's revised formula performed by NECA, 200 USF recipients would have their corporate operations expenses limited in varying amounts, with an overall reduction in the size of the USF of approximately \$35.7 million.⁸ The 200 companies negatively impacted represent approximately 35 percent of all USF recipients. It is arbitrary to assume, without factual record, that such a large percentage of companies incur expenses that are beyond the "range of reasonableness." This arbitrary reduction in cost recovery not only calls into question the "sufficiency" of support, but also has the potential to impact the affordability and comparability of rural rates, in contravention of Sec. 254(b), the

⁸ While a reduction of \$35.7 million would almost certainly have a detrimental impact on the companies affected, it represents only a five percent reduction in the total fund for 1997. Thus, continuing to allow companies to recover their corporate expenses absent a formula would have a negligible impact on the size of the fund.

principles that are now the very core of the universal service concept. The Commission should not adopt a formula that has the effect of harming rural companies and subscribers.

IV. THE FCC HAS NOT GIVEN REASONABLE NOTICE OR DEVELOPED A SUFFICIENT RECORD TO IMPLEMENT ITS FORMULA

The FCC does not have an adequate or sufficiently recent public record from which to derive its untested formula that will cause a significant reduction in many carriers' universal service funding. There is no mention whatsoever of a cap on corporate operations expense anywhere in the CC Docket No. 96-45 proceeding, including both the FCC's NPRM and Public Notices, as well as the Joint Board's Recommended Decision. Instead, the Commission is forced to reach back to its NPRM and comments filed in CC Docket No. 80-286, where a proposal to exclude administrative costs is given all of four sentences.⁹ This is not an acceptable substitute for notice that the Commission intended to cap corporate expenses in this proceeding. The Joint Explanatory Statement of the 1996 Act states that the conferees did not view the 80-286 proceeding as an appropriate foundation on which to base the proceeding required by Sec. 254(a).¹⁰ Furthermore, as previously noted, the public has never been given an opportunity to comment, in any proceeding, on a proxy formula that would limit corporate expense recovery. The FCC should not implement its corporate operations expense limitation without first informing itself of what impact its action will have and providing interested

⁹ Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board, CC Docket No. 80-286, Notice of Proposed Rulemaking and Notice of Inquiry, FCC 95-282 (rel. July 13, 1995), para. 35.

¹⁰ Joint Explanatory Statement of the Committee of Conference, p. 131.

parties with an opportunity to propose alternatives and comment substantively on its proposal.¹¹

V. COMMISSION RULES MUST ALLOW ADVERSELY AFFECTED COMPANIES TO DEMONSTRATE THAT THEIR COSTS ARE REASONABLE

The Commission announces that it will not grant waivers to provide additional support for corporate expenses absent “exceptional circumstances” because it believes corporate operations expenses that exceed the maximum permitted by its formula are not necessary for the provision of universal service.¹² The summary manner in which the Commission has promulgated this formula, coupled with its adverse impact on so many companies, necessitates a far less burdensome remedial procedure to permit individual companies’ recovery of reasonable costs. The statement that carriers must show “exceptional circumstances” suggests an added burden but the Commission fails to explain what it considers “exceptional.” At a minimum, the Commission should explain what criteria it will use to determine “exceptional circumstances.” But beyond that, the RTC believes any waiver process governed by Wait Radio v. FCC, 418 F. 2d 1153 (D.C. Cir. 1969), is an inappropriate vehicle for remedying the hardships the new rule will impose. Carrier expenses should be presumed reasonable so that the high hurdles that operate under Wait do not present an insurmountable obstacle in overcoming this summarily adopted formula. Both the large number of potential companies

11 The failure to provide notice and consider alternatives with less harsh impacts also fails to comply with the Regulatory Flexibility Act, 5 U.S.C. §603. The Commission has not considered alternatives to reduce the significant adverse economic impact its proposal will have on the 200 affected small companies.

12 Order, para. 285.

affected and the adverse impact of the limit in the formula require a procedure that keeps affected companies out of the lengthy and expensive waiver procedures that will only add more to the corporate operations costs of these companies. The application of Wait principles and procedures to these proceedings will not promote the ultimate objective of universal service or the deregulatory purposes of the Act.

If the Commission lawfully adopts some formula limiting allowable costs, the RTC recommends a simple procedure to accommodate eligible carriers that incur costs in excess of the maximums. Such a procedure should include a presumption that all costs included in corporate expense accounts are legitimate unless proven otherwise. The RTC believes that a tariff-like procedure would meet the Commission's concerns with the least amount of disruption in quality service and infrastructure development and eliminate the substantial litigation costs and burdens that customers and the public ultimately would bear as a result of the litigation and processing of multiple waiver applications before the Commission and appeals before the courts.

VI. CONCLUSION

Without the expense items recorded in the USOA corporate operations accounts, the provision of telecommunications service to high cost areas would not be possible. The operating expenses of carriers vary for many reasons other than the number of access lines. The Commission's formula to limit these expenses has not been proven to determine with any accuracy what is a reasonable level of expense and would only serve to jeopardize the provision of universal service. If the Commission is determined to limit recovery, it must, at

the very least, give interested parties an opportunity to comment on any proposal or formula prior to its adoption and include a presumption of reasonableness. In the meanwhile, the RTC urges the Commission to abandon the formula in its Order on Reconsideration and continue to allow carriers to recover their reasonable and prudently incurred corporate operations expenses through the current USF.

Respectfully submitted,
THE RURAL TELEPHONE COALITION

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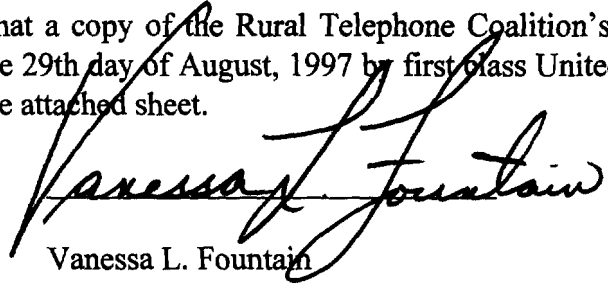
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August 29, 1997

CERTIFICATE OF SERVICE

I, Vanessa L. Fountain, hereby certify that a copy of the Rural Telephone Coalition's Petition for Reconsideration was sent on this, the 29th day of August, 1997 by first class United States mail, postage prepaid, to those listed on the attached sheet.

A handwritten signature in black ink, reading "Vanessa L. Fountain". The signature is written in a cursive style with a large, stylized "V" and "F".

Vanessa L. Fountain

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